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1 General review

1.1 Major agricultural market developments in 2005

Despite unfavourable climatic conditions, particularly for crop production, in 2005 there were no substantial changes on the agricultural markets. According to preliminary data agricultural production declined compared to previous year by 5.1%, as drop in crop production was estimated at 10.5% while the increase in livestock production amounted to 3.5%. The decline in crop production was a result of flood through the country over the summer and the autumn, as the drop in cereals and potatoes production was estimated at 29.8% and 29.6% respectively. But having in mind the cereals stocks from the previous year the domestic supply remained relatively high, providing for domestic demand and export (1.6 million tonnes of grains have been exported).

Share in GDP

Farm gate prices increased by 2.4% compared to 2004 as the increase in livestock prices was more substantial (3.7% compared to 1.5% for crop products). The highest increase was observed in farm prices of feed (fodder) crops, fruits, vegetables and wine grapes as well as in prices of live animals. As a result of the low quality of grains, the prices of cereals declined by 20% with exception of barley which remained at the previous year's price level.

The prices of farm inputs increased over the year. This refers not only to prices of oil and gas (for which the price transmission between world and domestic prices is perfect) and for which an increase in excise tax was introduced but also to prices of fertilisers and seeds. This increase in input costs of farmers could not be offset by the support provided by the State Agriculture Fund. As a result the terms of trade worsened which reflect negatively on farm income.

Foreign trade

Bulgaria has always been a net exporter of grains with exception of 1996 when the wheat harvest was abnormally low. Grains and in particular wheat and barley have an important share in Bulgarian agricultural exports. The import of grains is symbolic. The share of grain export in total agricultural export varies between 8% and 15%. The net export of grains is on average 25 to 30% of the domestic production. Wheat is the country's most important grain, with exports of wheat between 0.5 and 1.2 million tonnes depending on the harvest. Barley exports account for 300000 tonnes on average, while maize exports depend strongly on the level of maize production which varies substantially year to year.

Consumption

Domestic consumption of grains is relatively stable showing slight increase over the period, accounting for 3.5 to 4 million tonnes, of which 2.2 to 2,5 million tonnes of wheat. Human consumption consists of 1.3 million tonnes of wheat (for bread and flour), 150000 tonnes barley for brewing and 250000 tonnes of maize for food and industrial use. The observed increase in domestic consumption of grains is due to the increase in the amount of grains used

for feed due to the increase in the number of animals. The feed use of grains varies from 1.8 million tonnes to 2.3 million tonnes depending of the year. Wheat and maize used for feed is between 0.6 and 1 million tons, while feed barley is relatively constant (0.35 to 0.4 million tons).

1.2 Agricultural and rural policy developments

In 2005 there were no changes in the agricultural policy applied compared to the previous years. The price and trade policy remained liberal with the exception of tobacco and milk for which price subsidies remain. The support to agricultural producers increased slightly, as the replacement of the post-1996 short-term credit schemes by direct payments schemes carried out over recent years continued. In 2005 support was provided to grains, sunflower seeds, rapeseeds, sugar beet, potatoes, tomatoes and red paper and livestock producers (for covering part of the feed costs in January and February). The lower interest rate long-term credit schemes remained practically unchanged though their importance to farmers declined as a result of macroeconomic stabilisation and reduction in interest rates. In addition to the traditional instruments, in 2005 LFA payments were introduced (applying in 6 mountain regions).

The other source of support to farmers was the SAPARD programme. The measures applied are part of the amended National Rural Development Plan in the following areas: investments in farms (mainly milk, meat, permanent crops and vineries); improvements in food processing (to meet the EU criteria); and extending the economic activity in rural regions.

1.3 Issues related to the enlargement

In 2005 the efforts of the MAF and policy makers were focused on preparation for adoption of the CAP. The Veterinary ACT was approved by the Parliament and a large number of regulations were approved by the Council of Ministers referring to veterinary activity and control, creating the legal framework for the paying agency and its activity, creating registers for producers (in milk sector, wine sector), applying the milk CMO, etc. Despite the efforts of the policy makers, the EU's autumn report for Bulgaria outlined three 3 main problem areas (veterinary activities, paying agency and milk CMO) with substantial delay in preparation. Detailed measures that had to be taken were included in the National Action Plan and were monitored weekly by the Committee for Monitoring and Control of preparation for joining the EU. 23 measures in the field of agriculture were included in the Action Plan.

Under the initiative of the Minister of Integration an expert group of independent experts was assigned to prepare a pre-monitoring report on progress in fulfilling the National Action Plan. The results of this first internal monitoring showed that by the end of January only 5 of 22 measures had been completed, 8 measures were in an advanced stage of fulfilment but the other 9 measures were only at an early stage. The most critical areas remain border veterinary inspection, restructuring of food industry (dairy and meat processing), taking political decisions on the direct payments scheme (including bring in a law), creating the paying agency and organising ISAC and LPIS. These results were confirmed by the twinning partners' peer reviews carried out since the beginning of 2006. In the last two months the preparation of Bulgaria in the field of agriculture improved substantially. The final report of the expert monitoring showed that by mid March 2006 86% of the measures monitored are

either fulfilled or at very advanced stage. Border veterinary inspection; restructuring of the food industry (dairy and meat processing); and LPIS are still behind schedule.

2 Assessment and outlook: market integration in the cereal sector

2.1 Introduction

The Bulgarian cereals sector is traditionally one of the most important agricultural sectors in the country. Grain production represents 15 to 20% of Gross Agricultural Output. The share of grains in total crop production fluctuates over the years around 30%. The area under grains accounts for above 60% of total arable land or approximately 2 million HA. The most important grain is wheat followed by maize and barley. The wheat area varies around 1 million HA, or half the total grains area. The least important grain from the point of view of production and area is rice (around 5000 HA).

The total cereals production varies between 4 and 7.5 million tonnes, depending on weather conditions. The average yield of wheat in the last three years was 3.1 t/ha but varies quite a lot through the years between 3 and 3.8 t/ha. The same is valid for maize and barley.

Domestic consumption of grains is relatively stable showing a slight increase in feed consumption as a result in increase in number of animals in recent years. It varies between 4 and 4.5 million tonnes. Human consumption of wheat is approximately 125 kg per capita or 1.3 million tonnes. Industrial use of barley and maize is around 400000 tonnes of which 250000 tonnes maize and 150000 tonnes barley. Feed represents 2 – 2.5 million tonnes.

Bulgaria has always been net exporter of grains, mainly wheat and barley. Trade in maize varies from year to year, depending on the crop.

Since 1997 the Bulgarian grain market has been completely liberalised. Controls on prices and all restrictions on exports have been removed. As a result price the large price gap between domestic and world market prices (as well as EU average prices) was offset and price transmission improved substantially.

2.2 Storage capacity and transportation

There are two types of storage capacity in Bulgaria. The first group includes on-farm capacity and storage capacity of milling and feed production enterprises. The second group includes public grain warehouses and stores. There is no official data for the total capacity of the first group, but according to the expert estimates it is about 1 to 1.2 million tonnes. These stores are evenly spread in the country regions but they are not licensed according to the Grain Law¹ and could be used for the owners needs only. In general the on-farm stores are small with few, mostly out of date, facilities. They are used for temporary storage of grains and do not meet the requirements for longer grain storage. This makes farmers sell their production immediately after the harvest at the lowest prices which results in low profitability. Introduction of the warehouse receipts system in 1999 allowed this problem to

¹ Law for grain storage and trade

be solved to some extent but usually only about 250000 tonnes of grain is stored using this system.

Many of the milling and feed processing enterprises have relatively large stores compared to their production capacity, with appropriate equipment and in general are used for storing grain for their own needs over the whole year.

There are 176² warehouses and grain stores in the second group. The capacity of grain warehouses and stores amounts to some 1.5 million tonnes in total as warehouses alone accounts for 0.5 million tonnes. Both types of storages are licensed under the Grain Law. The warehouses could be used for grain storage under the warehouse receipts system introduced in Bulgaria in 1998, while other licensed storages are not allowed to participate in this system. Both warehouses and other storages have to be licensed annually. There has been little change in total storage capacity in recent years. The level of technical equipment of these storages meets all requirements for grains storage. The majority of the licensed public storages (about 60%) belong to traders, the rest to processors (milling, feed processing, and breweries). This creates some asymmetry in the market and leads to higher storage costs for farmers.

According to the MAF data, 90% of the storages and 72% of the storage capacity is in the north which accords with the north's share of the country's grain production. However, licensed storage capacity in south Bulgaria is still low with only 5 public warehouses and 43 grain stores with 32000 tonnes and 365000 tonnes capacity respectively.

Transportation

Bulgaria's transport system is well developed but the road system has been poorly maintained though no major problems exist in transporting cereals by road. . Despite the potential advantages of transporting cereals by rail, inadequate infrastructure for direct loading of grain onto railway wagons has limited the use of rail transport. The limited flexibility of railway operations is also a restricting factor. There is also limited capacity for loading ships and this results in more than half of grain exports are transported by road.

2.3 Quality

In recent years, the proportion of high quality wheat has tended to decline and that of feed wheat to increase, the latter being now around 70% of the total, though about 30% of the feed wheat classified as feed wheat is of relatively good bread making quality.

2.4 Market distortions

At the beginning of transition, over the period 1989 – 1997, due to bans imposed on exports the domestic market isolated, from world trade and surplus production resulted in domestic prices being substantially below the world market level, in some cases only around half the world price. Since privatisation of mills and market liberalisation (removal of price control and export bans) in 1997, there has been a substantial rise in grain prices as the gap between world and internal prices has shrunk. However, although farmgate prices have increased, the main

² by the end of 2005

beneficiaries have been traders and processors as the market power of farmers in the food chain remains low.

The poor financial situation of many farmers means they are still under pressure to sell grains immediately after harvest because they have to repay the loans or credits they received in the autumn and winter no later than October to be able to get new credits for the following year's production cycle. This is one of the main reasons for the low use of the warehouse receipts system (less than 10% of the grain harvested is covered by this system). The first-hand selling of wheat is mainly direct sale from farmers to processors or traders as only 5 to 8% of grain is sold on the three commodity exchanges (Sofia, Rouse and Plovdiv).

2.5 Assessment of market integration

As mentioned above after market liberalisation in 1997-1998 the isolation of the domestic grain market was offset. The price gap between domestic and EU prices³ has been practically closed and the price conversion improved substantially⁴. Another study⁵ shows that wheat prices in the Balkan countries is tending to converge to a common level other than in Turkey⁶. Both studies show that by the end of the period:

- Substantial improvements in the grain market performance have been observed over the period 2000 to 2004, including improvements in the seasonal pattern and by the end of the period Bulgarian wheat market performs well;
- Bulgarian wheat market is practically well integrated with the EU market as well as with the Balkan countries wheat markets. The current strong correlation between domestic and EU prices indicates that EU prices and trade with the EU are among the main determinants of the domestic price.

³ French wheat prices used as benchmark.

⁴ Real price analysis of grain and Producer Support Estimates for key products in Bulgaria, Background paper for an World Bank study, 2004

⁵ Regional Commodity Exchange Final project Report, 2003, ASDA-VOCA

⁶ Prices in Turkey are substantially higher than in the rest countries in the region mainly due to the high level of support.